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Supreme Court of the United States

October Term, 1930.

No. 378.

STANDARD OIL COMPANY (INDIANA), STANDARD OIL COMPANY (NEW JERSEY), THE TEXAS COMPANY, GASOLINE PRODUCTS COMPANY, *et al.*, *Appellants*,

vs.

UNITED STATES OF AMERICA, *Appellee*.

SEPARATE BRIEF OF THE TEXAS COMPANY, ONE OF THE APPELLANTS.

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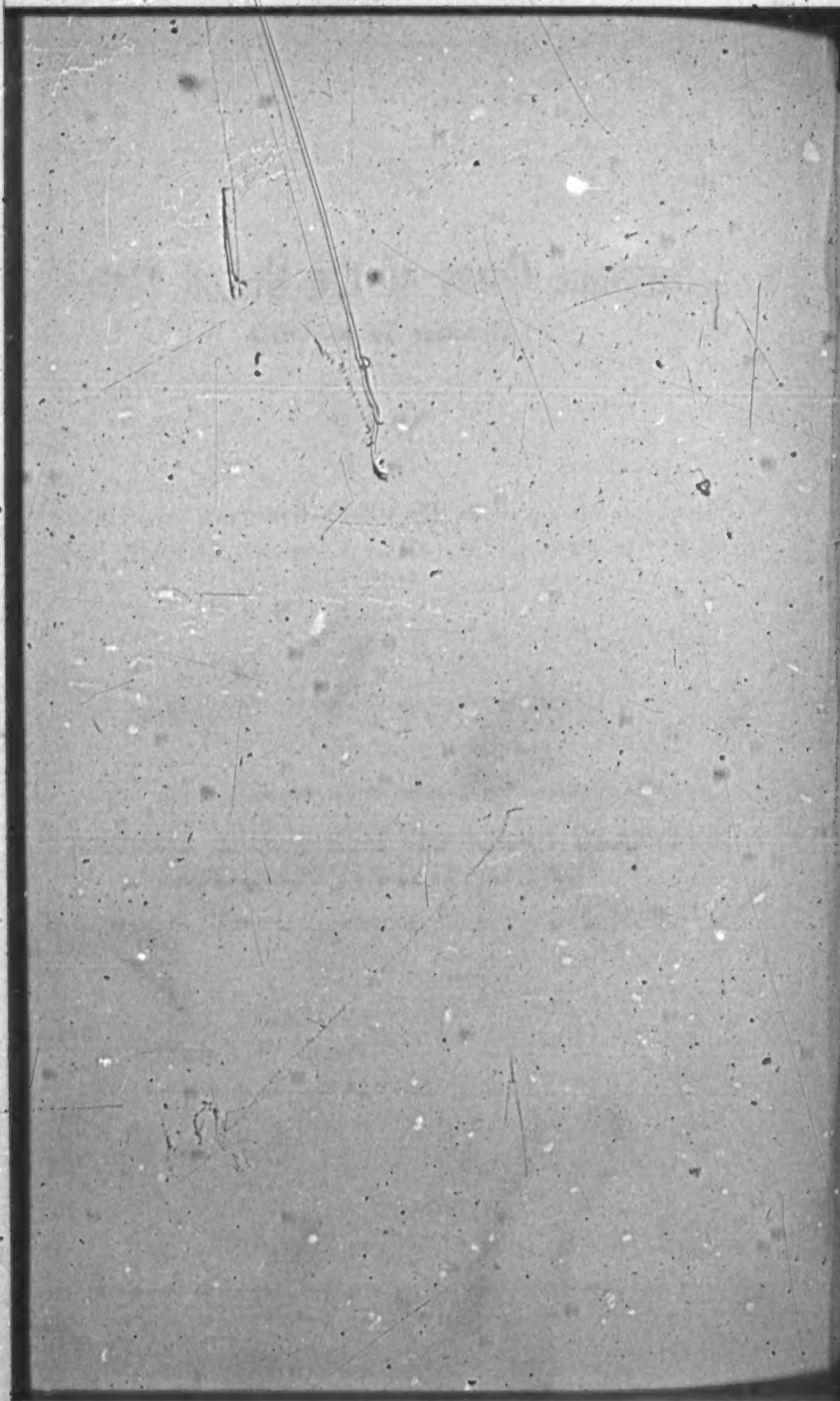

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FIRST: There has been filed in this cause a brief on behalf of the four appellants above named who are referred to as the primary defendants, and in that brief The Texas Company has joined. It is believed, however, that it may be helpful to the Court if this supplementary brief is filed to disclose the point of view of The Texas Company, its purpose in making the contracts, and to point out their effects.

SECOND: It may be stated at the outset that the only part of this record which requires careful examination is that pertaining to contracts Nos. 31, 55 and 74. An enormous record has been made. It has been greatly abbreviated before being brought here, but even so, much has been

brought here which is unimportant in deciding the necessary issues involved. For example: there are several hundred pages of evidence pertaining to the validity of a large number of patents. Pages 2111 to 5097, Volumes IV to VIII, contain this patent evidence. Both the Master and the lower Court found these patents valid. Our contention has been from the start that testimony attacking the validity of these patents was incompetent because, for the purpose of this case, their validity must be assumed. The competency of this testimony, however, becomes moot, since the attack on the patents has failed.

Eliminating the issue of patent validity, there remains only the question of the validity of the seventy-nine contracts described in the bill filed by the Government. Of these, the only ones having any important bearing on the issues involved are those numbered 31, 55 and 74. Of the seventy-nine contracts, nine of them only are between the primary defendants,* and of these nine, six are merely ancillary to either Number 55 or Number 74, and require no separate examination except for the purpose of verifying our statement. The other seventy are merely licensing agreements by which one of the primary defendants licenses one of the secondary defendants under its patent rights. Of these seventy licensing agreements, The Texas Company is licensor in only three or four. It is not a party to the others and has no control over their provisions which are attacked by the Government.

The Government's Bill is not directed against these seventy-nine contracts as a whole but only against certain

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* Numbers 4, 5, 12, 15 and 21 were mere licenses issued by the Standard Oil Company (Indiana) to the Standard Oil Co. (New Jersey) and were not cross-licensing agreements. Four of these nine relate entirely to foreign operations.

provisions thereof which the Bill describes as restrictive covenants, and it sub-divides these restrictions into four classes.

Class "A" Restrictions.

These are thus described in the Bill (I 26):*

> "Provisions which directly restrain interstate and foreign trade and commerce by prohibiting the transportation of commodities into the Indiana Company territory."

The Texas Company is not a party to any contract containing these restrictions. They are merely provisions in a number of separate and distinct agreements by which the Standard Oil Company (Indiana) licensed individual refiners to use its Burton Process. The Texas Company has no interest in such restrictions and never did have. They are in license agreements issued by Standard Oil Company (Indiana) antedating the first Texas Company agreement —Number 31.

Class "B" Restrictions.

These are thus described in the Bill (I 30):

> "Provisions which operate to restrain interstate and foreign commerce, and to create a monopoly therein by affording the Indiana Company the option to purchase a percentage of the gasoline produced within, or shipped into Indiana Company territory."

The Texas Company is a party to some of the contracts containing this option clause, discussion of which will follow, and this is the only so-called restrictive covenant to which The Texas Company is a party.

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* In referring to the record the Roman numeral indicates the volume and the figures the page.

Class "C" Restrictions.

These are thus described in the Bill (I 32):

> "Provisions as to royalty rates and limitations on production which have the effect directly to restrain interstate and foreign trade and commerce in gasoline and other unpatented commodities."

These so-called restrictions are contained in certain licenses issued by Standard Oil Company (New Jersey) to some of its licensees, and by Gasoline Products Company to some of its licensees. In every case, they are merely part of a licensing agreement between the licensor on the one hand and an individual licensee on the other.

The Texas Company is not a party to any of these restrictions nor has it any interest in them.

Class "D" Restrictions.

These are thus described in the Bill (I 38):

> "Provisions having the effect to restrict and to restrain the foreign trade and commerce of the United States."

These so-called restrictions are all contained in licenses issued by Standard Oil Company (Indiana) to various individual licensees which, without exception, were executed prior to the first of the so-called primary agreements which is Number 31. They were purely contractual arrangements between a licensor and its licensee and The Texas Company is not concerned in them.

We make this reference to the so-called restrictive covenants in order that the Court may see at the outset that these seventy-nine contracts, except as stated, are merely

contracts entered into over a period of ten years between one licensor who was an owner of patents and one licensee who wished the privilege of using licensor's process. They are not a series of contracts evidencing a common purpose and intent, but are separate and distinct agreements made at different times under different conditions and each for a separate purpose in respect of which only the parties to the particular agreement were concerned.

The validity of these so-called restrictive covenants is discussed in the main brief and we merely make the point here that so far as The Texas Company is concerned, their validity is wholly unimportant because The Texas Company, with the exception of the option clause, is not a party to these covenants and has no interest in them.

If The Texas Company had never appeared in this cause, but had permitted a decree *pro confesso* to be taken, and if this decree had been no broader than the specific prayers of the Bill, The Texas Company's operations under the contracts to which it is a party would not have been affected in any particular whatsoever except that an option which it had granted the Standard Oil Company (Indiana) would have been cut down. That option, however, had never been exercised; the conditions precedent to its exercise had never come into being, and for practical purposes we may say with accuracy that if the prayer of the petition had been carried bodily into a decree, the position and operations of The Texas Company would have been exactly the same after as before the decree.

The decree rendered by the Court, however, does not grant the relief which the Government sought. The Government did not seek cancellation of a single one of the seventy-nine contracts. It merely sought injunctive relief against certain portions of those contracts. Its prayer left intact

the licenses, cross-licensing provisions, and the sub-licenses. The relief awarded by the decree, however, strikes down many, if not all, of the contracts as a whole and leaves every one of the defendants as stark infringers of the patent rights of one or more of the other defendants, although the patents themselves have been adjudged valid.

We pass now to a discussion of the three important contracts, the first, the contract numbered 31.

THIRD: CONTRACT NUMBER 31. AUGUST 26, 1921 (II 1315).

(a) *What is it?*

It is a simple (*i. e.* non-exclusive) license granted by The Texas Company to Standard Oil Company (Indiana) under the patent rights of The Texas Company relating to cracking.

It is a simple license granted by Standard Oil Company (Indiana) to The Texas Company under the patent rights of Indiana relating to cracking.

It is a contract providing that either of the contracting parties may grant licenses to others under the patent rights of *both* parties.

It is a sweeping settlement of patent conflicts for the purpose of avoiding litigation between the two parties or between one of them and the licensees of the other.

Each party is left free in the future to issue licenses under its own patent rights upon any terms which suit its fancy.

If, however, either party issues licenses under the patent rights of both parties, the terms of the license must be acceptable to both parties.

Provision is made for the division of royalties collected by either party.

(b) *The Texas Company's situation at the time this contract was made and the general position of the industry.*

Having briefly stated the substance of this contract, we shall now undertake to present to the Court a picture of the general situation obtaining in the petroleum industry and of the Texas Company's particular relation to that situation. If we can draw this picture accurately the Court will see that this contract does not unreasonably restrain commerce, that in fact, it does not restrain commerce at all, but on the contrary, is a perfectly normal, constructive step in the development and extension of commerce by relieving the parties and their licensees from the jeopardy of patent infringement.

This case deals with one of the most vital forces of the most inventive age in human history. In its development we see the minds of able men grappling with a moving, living, ever-changing problem of the present age, namely, the problem of supplying adequate fuel for a new engine —gasoline for the automobile engine.

Prior to 1900 gasoline was unimportant. The difficulty in the petroleum industry was in disposing of it. One of its principal uses was in taking grease spots out of soiled clothes. Kerosene was the desired product of refining crude petroleum. In 1904, of the crude passing through the refineries, 10% was converted into gasoline and 48% into kerosene, while in 1925, 32% was converted into gasoline and only 8% into kerosene (II 874-876). In the best-equipped refineries today the output of gasoline is as much as 60% to 70% of the crude. Today gasoline instead of being a byproduct is by all odds the chief product of petroleum refining.

In 1900 there were 8,000 automobiles in the United States, while in 1925, there were 19,954,347.

The following table presents the statistical side of the picture.

AUTOMOBILE REGISTRATIONS, CRUDE OIL AND GASOLINE PRODUCTION IN THE UNITED STATES.

Year	Automobile Registrations	Crude Oil Production Barrels	Production Gasoline Gallons	Gasoline produced by cracking, included in preceding totals
1900	8,000	63,621,000		
1901	14,800	69,389,000		
1902	23,000	88,767,000		
1903	32,920	100,461,000		
1904	55,000	117,081,000	290,556,000	
1905	78,000	134,717,000		
1906	107,000	126,494,000		
1907	142,000	166,095,000		
1908	197,500	178,527,000		
1909	312,000	183,171,000	540,330,000	
1910	468,500	209,557,000		
1911	639,500	220,449,000		
1912	994,000	222,935,000		
1913	1,258,062	248,446,000		
1914	1,711,339	265,763,000	1,502,718,000	85,176,000
1915	2,445,666	281,104,000	1,625,106,000	174,006,000
1916	3,512,996	300,767,000	2,162,370,000	291,774,000
1917	4,983,340	335,316,000	3,068,310,000	413,490,000
1918	6,146,617	355,928,000	3,794,700,000	494,096,000
1919	7,565,446	378,367,000	4,246,284,000	640,412,000
1920	9,231,941	442,929,000	5,218,248,000	678,174,000
1921	10,464,715	472,183,000	5,552,274,000	892,626,000
1922	12,239,853	557,531,000	6,624,366,000	1,065,876,000
1923	15,092,177	732,407,000	8,164,506,000	1,190,280,000
1924	17,595,373	713,940,000	9,363,774,000	1,443,036,000
1925	19,954,347	763,743,000	11,173,806,000	2,880,486,000

(II 870, 882.) The last column is supported by p. 882 where barrels are shown. These are reduced to gallons by multiplying by 42.

These statistics show the rapid growth of the automobile industry (which has been even more rapid since this record closed), the increase in the crude oil production, which it will be noted is at a very much slower rate than the increase in gasoline production, and most important of all, it shows the enormous increase in the production of gasoline by cracking. The table shows the results which have been achieved, but it does not show the tedious and tireless research nor the laborious and persevering experiments which produced these results.

The Texas Company was one of the pioneers in the effort to obtain these results, and this record shows that The Texas Company and the Standard Oil Company (Indiana) were the leaders in the movement. Obtaining the enormous increase in the output of gasoline was not a simple thing and the modern cracking processes are not simple operations, but a complicated series of steps including the separation and preparation of the oil to be cracked, heating it to the proper temperature, holding it at the proper temperature for an adequate time, preventing too much deposition of coke and depositing the inevitable quantities thereof at points where they will do the minimum of harm, separating the various products of reaction, fractionating, condensing and purifying the gasoline, separating and recovering certain intermediate stocks suitable for further cracking and returning them (preferably hot) to the process, removing tarry matter before it can form coke and clog the apparatus, and evolving the necessary apparatus for carrying on progressively and continuously all of these complicated problems in the most economical and efficient manner.

The Texas Company began an intensive study of this subject in 1911 and during the following seven years, de-

voted much attention to developing a cracking process. During that time, it expended more than $500,000 in experimental work and by 1918 had progressed to a point where it was willing to expend large sums in commercial installations. During 1918 and 1919, it expended about $3,000,000 in the construction of its first cracking units at its refinery in Port Arthur, Texas, and named its process the Holmes-Manley Process, Messrs. Holmes and Manley being the men directly in charge of its refining operations and inventors of some features of its process (II 897).

Parallel with its research and development efforts, it was also securing patent protection for its inventions. In 1911 it had a brief contact with an independent inventor named Adams who for several years had been working on the cracking problem, and in 1914, made a contract with Adams under which, as amended, it secured the benefit of his inventions and patents. It likewise secured patent protection for the inventive contributions made by Holmes, Manley, Behimer and others in its regular organization. Important patents were issued in 1919 and early in 1920. By the early part of 1920, The Texas Company had expended over half a million dollars in experimental work, had planned and constructed its first battery of Holmes-Manley units, had expended $3,000,000 in their construction, and was planning to construct additional units at a cost of $14,000,000, which have since been constructed. It also had a number of patents covering various fundamental steps as well as some improvements, and was ready to proceed in a large way towards a great expansion of its refineries so as to meet the growing demand of the automobile industry and of the American people (II 897).

During this same period Standard Oil Company (Indiana) had likewise been actively and independently engaged in attacking the same problem, and had developed a

cracking process known as the Burton Process. The Burton Process was covered by various patents owned by Standard Oil Company (Indiana), the first one being the Burton patent which was issued in 1913. Between 1913 and 1920 Standard Oil Company (Indiana) had installed and was using the Burton Process in a large way. It had issued about 30 licenses to various other refiners under which some of them had likewise installed the Burton Cracking Process, and several of these licenses were still in effect when The Texas Company's units were completed and its patents issued.

The Burton Process of the Indiana Company and the Holmes-Manley Process of The Texas Company were, at that time, the only two commercial cracking processes in the field (I 652).

While the Indiana Company's Burton patents were issued in 1913, and therefore, prior to the issuance of The Texas Company's Adams patents, the Adams application bore a 1909 date and was earlier than the Burton application. Adams' application had been much delayed in the Patent Office, but as his invention antedated Burton's, and his date of application was prior to Burton's, Mr. Dearborn, The Texas Company's patent attorney, was of the opinion that the Burton Process was an infringement of The Texas Company's patents. He accordingly served a warning notice on Standard Oil Company (Indiana) early in 1920, and The Texas Company was in turn notified of infringement of some of the Indiana Company's patents.*

* The patent situation was not simple. When this contract was executed, the Standard of Indiana had twenty issued patents and ten pending applications, while The Texas Co. had four issued patents and thirty-one pending applications (II 1322), all of which had an important relation to their respective processes.

Patent counsel for both companies gave the subject most careful consideration and concluded that the Indiana Company was infringing some of the claims of The Texas Company's patents, and The Texas Company was infringing some of the claims of the Indiana Company's patents. Under these circumstances a very practical problem was presented to the executives of the two companies. They might sue each other for infringement, but if the suits terminated as their patent counsel thought, they would both find that they were infringers and would be enjoined from the use of some important features of their respective processes and subjected to the payment of uncertain, but possibly very large, sums as the result. On the other hand, they might settle their differences by each giving to the other and to the other's respective licensees, present and future, the full benefit of all its inventions; and they might cooperate in further development work and evolve improvements which would make a better process than either of them then had.

Relative to the making of this contract, Mr. R. C. Holmes, President of The Texas Company, and the Holmes for whom the Holmes-Manley Process was named and who is one of the inventors of that process, testified as follows (II 897):

> "R. J. Dearborn is the Patent Attorney of The Texas Company and has been employed in that capacity since January, 1919, devoting his entire time to the business of the Company. When we began installing the Holmes-Manley units, we knew that the Standard Oil Company of Indiana was operating and licensing the Burton process. After the issuance of the Adams patents referred to, I consulted Mr. Dearborn with reference to the patent situation as it then existed as between The Texas Company and Standard Oil Company of Indiana, and Mr.

Dearborn advised me that the Burton process as operated by the Standard Oil Company of Indiana and its licensees was an infringement of the Adams patents and other patent rights owned by The Texas Company. By reason of this advice The Texas Company, in July, 1920, served a warning notice or notice of infringement upon the Standard Oil Company of Indiana, the result of which was either a conference with representatives of that Company or a claim on the part of that Company that our Holmes-Manley process was an infringement of the patent rights owned by the Standard Oil Company of Indiana. Mr. Dearborn thereupon made a thorough study of the patent situation and advised me that apparently there was overlapping of the patent rights of the two companies and we decided that it was desirable to bring about a settlement if we possibly could. We had built up a large cracking operation in the Holmes-Manley process while the Standard Oil Company of Indiana was a large operator and licensor of the Burton Process, and in view of the fact that litigation would probably be uncertain and long drawn out and our investments and profits imperiled, we concluded that a settlement would be advisable. We discussed the matter with Mr. Adams and after careful consideration he agreed with us that that would be a wise course. At that time we had no licensees as the Adams patents had recently issued. Our negotiations with the Standard Oil Company of Indiana extended over a period of about a year and the result was a settlement shown by the Contract No. 31 (Exhibit 31) between The Texas Company and the Standard Oil Company of Indiana dated August 26, 1921. At that time we had a group of patents and the Standard Oil Company of Indiana had a group of patents. The Holmes-Manley process operated by us was in some particulars covered by the patents owned by the Standard Oil Company of Indiana, while the Burton process operated by them was in some particulars covered by the patents owned by

> The Texas Company. We had charged them with infringement and they had countered with a like charge. If we had gone to litigation suing them for infringement of our patents, and had been sued by them for infringement of their patents, our operations would have been threatened; the litigation would have involved long delay and great expense with an uncertain result and rather than engage in that litigation, in order to protect our own operations and be free to expand in a large way, we concluded that a settlement was advisable if it could be arrived at on a fair basis."

In this he is corroborated by Mr. Dearborn (II 919) and there is no contradiction.

Relative to the making of this contract, Mr. R. W. Stewart, Chairman of the Board of Standard Oil Company (Indiana), testified as follows (II 1017):

> "The circumstances leading up to the execution of Contract No. 31 (Exhibit 31) dated August 26th, 1921, between The Texas Company and my company, were that we had been advised that The Texas Company had become the owner by assignment of certain patents or applications for patents made by one Adams. A notice to the effect that The Texas Company claimed our operations infringed the Adams or Texas Company's patents was served upon us by The Texas Company after the Adams patents had been issued. It was the operation of our Burton processes, and other patents obtained by Burton and his associates—our operations under those patents —that infringed the Adams patents.
>
> Our attorneys further advised us that the applications for the Adams patents had been filed prior to the filing of the Burton applications. They advised us that there were a great many questions as to whether or not the operations of The Texas Company would not infringe our patents. They told us

that these questions were such that the courts might decide either way. They felt satisfied that there was a fair chance to win, but they also felt that there was a chance the other side might win. We gave very careful consideration to this proposition. Our attorneys were in constant conference with us, and the fear was entertained by our Board, that we were going to get into a long, protracted litigation, which would be very costly, harassing and annoying. Being this kind of litigation, it would have a bad effect upon our operations. During the course of these negotiations some of our people had seen some of the operations of The Texas Company, and were greatly impressed by the Holmes-Manley development. They achieved a tremendous respect for Mr. Holmes and his research department—the research department of The Texas Company. We had considered all these points, particularly the character of the litigation, and its extent, how long it would last, and we finally made this contract with The Texas Company, to which my attention has been called. They granted us cross immunities, gave us the opportunity to have the benefit of the Holmes research department, and an opportunity to put in use the Holmes-Manley units, which we afterwards did, and are doing today. Hence we thought it a desirable thing for us to do."

The strength of The Texas Company's position rested both upon its patent situation and upon the merits of its process. Respecting its process the Court quotes from the Master's report, with apparent approval, the following (III 1996):

"This Holmes-Manley continuous cracking process is almost universally agreed to be the highest embodiment of the art of bulk pressure distillation. Whereas, the Burton and Clark, and Clark processes

enabled the operator to handle 20,000 gallons of cracking-stock in a cycle of two days (or about 10,000 gallons a day), with the result of obtaining thirty to thirty-five per cent. of gasoline, the Holmes-Manley process puts through approximately 70,000 gallons per day, or seven times as much as the Burton-Clark process, and makes around forty per cent. of gasoline and runs for a period of fifteen to thirty days and frequently longer before having to be shut down because of coking."

The weakness of The Texas Company's position was that its practical men in charge of experimental and developmental work had developed a process which was open to serious attack by the patents of its rival, the Indiana Company. In this respect the Court quotes from the Master's report with apparent approval, the following (III 1997):

"The Holmes-Manley commercial cracking-still embodies in its structure and operation, the inventions of a number of the patents of the defendants. A number of its features are disclosed in the various patents to Adams; others are in the patents issued to Manley, to Holmes, to Behimer, and to Holmes and Manley jointly. It embodies also some of the claims of Clark, Humphreys, Burton (1,160,689), Lewis & Cooke, Burton & Clark (owned by the Standard of Indiana) and some of the claims of Ellis (owned by the New Jersey Company)."

The strength of the Indiana Company's position rested on the possession of patents covering some features of The Texas Company's process, and on the fact that it already had a number of licensees of its Burton process and was receiving from them substantial royalties.

The weakness of the Indiana Company's position was that the Holmes-Manley Process was a great improvement

over the Burton Process, that it could not use the Holmes-Manley Process without a license from The Texas Company, and that its Burton Process in some particulars infringed some of The Texas Company's patents.

Under all these circumstances, the first consideration of The Texas Company was to secure protection for its own large operations. It was primarily a refiner and it foresaw the enormous development of the motor industry and the necessity for enormous progress in the petroleum industry in order to supply the world's requirements. It wished to go into the cracking business on a much larger scale and it wished to do so without fear of patent infringement. After devoting some seven or eight years to the development of its process, and after succeeding in developing a process such as that described by the Master, the discovery of serious patent complications was quite disturbing. We repeat, therefore, that its primary interest was to secure freedom for its own operations.

Its secondary interest was to secure revenue from licenses granted to others to use the inventions it had developed and patented at such large expense.

The Indiana Company was equally concerned when it found that The Texas Company's Adams patents were infringed by its Burton operations, and that these patents, while issued later, antedated the Burton patents in time of application. It had been operating the Burton Process on a large scale for several years and had licensed it to a number of other refiners. It was, therefore, in jeopardy by reason of its own operations, and all of its licensees were in like jeopardy. It desired primarily to secure two things: (1) protection for its own operations and that of its licensees, and (2) the right to use the Holmes-Manley Process because of its improvement in the art.

Under these circumstances Contract Number 31 was entered into. By it both companies received protection for their own operations and freedom to use the inventions of the other. This same protection was extended to existing and future licensees. The Indiana Company agreed to pay The Texas Company 25% of the royalties it was collecting from existing licensees, and both companies agreed that royalties collected from future licensees should be divided equally between them.

The only thing that was restrained by this contract was litigation.

The situation of the parties at that time and the problem before them had been well stated in an opinion of this Court rendered only two years before their negotiations commenced. In *United States* v. *United Shoe Machinery Co.*, 247 U. S. 32, decided May 20, 1918, this Court, at page 53, said:

> "* * * No one can tell the strength of the competition that may be in a patent. It may be more than competition; it may be destruction, and the Anti-Trust Act surely does not require the acceptance of that or forbid effort to prevent it. But even if such extreme does not impend, certainly improvement of business and its efficiency can be striven for without offense to the law."

Their conduct and this contract were well within this definition of legal right and that they believed their conduct involved no violation of the law is demonstrated by the fact that there was no concealment of the contract. The fact of its having been made and the patent conflicts between the two companies having been settled was publicly announced in the newspapers (II 900).

The only feature of this contract which was challenged by the prayer of the Bill was the so-called option clause by which the Indiana Company was given the option to purchase part of The Texas Company's cracked gasoline if and when certain conditions ever came into existence. Those conditions, by the way, never have come into existence.

(c) *The Master's opinion of this Contract.*

In respect of this contract, the Master said (I 652):

> "As the Burton process and the Holmes-Manley process were at that time the only two commercial cracking processes in the field, and as there were fifteen or twenty refining companies practicing the Burton process, the execution of Contract 31 cleared up the entire industrial situation from a serious threat of complications, interruptions and liabilities. The general public was also benefited because it was not at all interested in patent controversies or litigations but only in an ample supply of gasoline at reasonable prices. By the development of the Burton process and the Holmes-Manley process, and the settlement of the controversy between the owners of the two processes, the public had an ample supply of gasoline at reasonable prices, and but for these circumstances undoubtedly there would have been a great shortage of gasoline and the public would probably have paid double what it did pay for the commodity.
>
> By the contract there was no limitation upon the perfect freedom of action and perfect control of each over its own patents and processes. There was no restraint upon the contracts of either. Each was free to execute as many licenses of its own process with immunity from any attack from the other as it might choose. There was no restraint of competi-

tion between the two companies and there was no agreement relative to either the amount of production or the price at which gasoline could be sold.

Immediately upon the execution of the contract, publicity was given to the fact that the contract had been entered into—so that there was no secrecy about it."

(d) *The Court's opinion of this Contract.*

In the opinion, the Court, speaking of this and also Number 55 and Number 74, says (III 2017):

> "Insofar as these agreements are license agreements, they are unobjectionable. To the extent that they go beyond license agreements, they are subject to the inhibitions of the Sherman Act."

The Court held that this contract was objectionable in the following particulars:

The option clause;

Recognizing the validity of unissued patents;

Dividing royalties;

Elimination of competition between the two groups of patent monopolies;

Its removal of the incentive to contest the validity of the patents.

The Option Clause.

The validity of this clause is fully discussed in the main brief for the primary defendants. We add only a few words. Referring to this clause, the Court says (III 2014):

> "It obligates The Texas Company to sell, under certain conditions, gasoline by it manufactured to the Standard Oil Company (Indiana). It is not restricted to gasoline manufactured by any process covered by any patent."

And again, in the next paragraph:

> "The vice of this covenant lies in the fact that there is no restriction as to the commodity which was the subject of the agreement. The product was gasoline manufactured by pressure cracking irrespective of the process used in producing it."

The Court is mistaken. Section I of the agreement shows that the whole subject being dealt with was "cracking under pressure" according to the patents of the two parties as recited in the exhibits. The Texas Company was both licensor and licensee. It took a license under the patents of the Indiana Company and it granted to the Indiana Company a license under its patents. The option clause (Section XIII) only related to gasoline produced by "pressure cracking" within certain states and this obviously relates to cracking under the patents previously referred to. The only option granted to Indiana by Texas was under certain conditions to purchase a certain percentage of the gasoline so made by it by "pressure cracking". Therefore, the Court was in error in construing the option clause as applying to anything except gasoline made by pressure cracking under the license. This being the only objection to the clause found by the Court, and this objection being based upon a misapprehension, the entire objection falls.

In addition to this, the Indiana Company waived the option at the suggestion of the Court, and in the next paragraph, referring to this waiver, the Court says (III 2014):

> "Were this the only provision objected to, we would view the litigation as happily ended."

Thus the option clause passes out of the picture (a) because it was a valid clause as shown by the principal

brief, (b) because the Court's one objection to it was based upon a misapprehension, and (c) because the Indiana Company waived it at the suggestion of the Court (II 736):

Recognizing the Validity of Unissued Patents.

We have nothing to add to the argument of the main brief on this point except that this was also waived at the suggestion of the Court, and that it was a mere statement of what the law implies (II 732/6).

Dividing Royalties.

Standard Oil Company (Indiana) was using its Burton Process for cracking on a large scale. Some fifteen other refiners were likewise using the Burton Process on a large scale under licenses issued by Indiana. They were paying Indiana substantial sums as royalties. These Burton operations infringed the patent rights of The Texas Company. Indiana desired a license to use the Holmes-Manley Process and it desired to protect its licensees against claims by The Texas Company for infringement.

The Texas Company had installed its Holmes-Manley Process for use on a large scale and was contemplating a much larger installation. This process infringed patents owned by the Indiana Company and it desired a license from the Indiana Company in order that it might continue the operation of its process.

Both companies recognized the probability of new inventions and improvements in the art of cracking. Each recognized the ability and importance of the other's past research work and the probable future contributions to be made. Both, therefore, desired cooperation in research and devel-

opment and freedom to use each other's new discoveries—as well as the existing patent rights.

Under these circumstances, Indiana needed a license under The Texas Company's present and future cracking patents and The Texas Company needed a like license under the Indiana Company's patents. Both companies had a perfect right to grant the licenses and, therefore, had the right each to charge the other therefor. What was the charge to be? Obviously, whatever the parties could agree upon. Each had property rights to sell, and each had a right to compensation for these rights.

The first question to be decided was the extent of the grant which each Company should make to the other and the compensation each was to receive. Should Indiana merely be granted immunity under The Texas Company's patents for the practice of the Burton Process, or should it be granted a full license to use the Holmes-Manley Process as developed under the patent rights of The Texas Company? Should The Texas Company merely be granted immunity for the practice of the Holmes-Manley Process under the Indiana patents or should it be granted a full license to supplement its own apparatus by the desirable features of the Indiana inventions? The decision was in favor of the latter course, and each company granted to and received from the other an unrestricted license to practice the inventions of the other so that each might have the benefit of the best process and the further and substantial benefit of new inventions to be made by the other.

The question then arose as to what compensation each should receive for this unlimited license. The answer was that insofar as their own operations were concerned, there should be a mutual exchange of licenses, neither Company paying anything to the other.

The next question was what to do with reference to the operations of the Burton Process by the existing licensees of Indiana. Indiana might have taken a license for itself and left its licensees unprotected and subject to suits for infringement by The Texas Company. This would have been lawful, but it would have been obviously unfair and unsportsmanlike. Indiana, therefore, had a lawful right (and at least a moral obligation) to protect its existing licensees against litigation, and The Texas Company had a lawful right to license those licensees of Indiana. Both companies agreed that this should be done. The question then arose as to what compensation The Texas Company should receive for these licenses. It was agreed that the licensees should be given complete protection, that they should not be required to pay a penny for this protection, but that Standard Oil Company (Indiana) should protect them by paying to The Texas Company 25% of the royalties thereafter collected from them by the Indiana Company. We submit that nothing could have been fairer.

The next question was what to do about future licenses. Both companies might have discontinued licensing and thereby have deprived the refining industry and the gasoline consuming public of the benefit of their inventions. They did not choose to do this but decided to give their inventions to the public for a consideration and to permit either company to issue future licenses to any refiner under the patent right of *both* companies. Obviously, in doing this, they had a right to make a charge and as the licenses might be issued under the patent rights of both companies, it was agreed that the royalties received from future licensees should be divided equally between the two companies. The rate of royalty for such *joint* licenses was agreed upon and it was agreed that it should be the same

as the Indiana Company was then charging for licenses under its own patents only. This, therefore, was obviously a fair and just arrangement.

We respectfully inquire what other arrangement could have been made. The term "pooling of royalties" may have an objectionable sound, but if these companies had the right to settle their patent differences, we submit that they could not have been settled on fairer terms even though we now, after nine years, look back upon the problem in retrospect.

There is nothing in the contract which prevents either company from issuing licenses *under its own patent rights only* for any royalty which it pleases to charge. The only instance in which the royalty is fixed by the agreement is where the license is being issued under the patent rights of *both* companies.

Elimination of Competition Between the Two Groups of Patent Monopolies. Removal of the Incentive to Contest the Validity of the Patents.

These two objections to the contract voiced by the Court are merely different forms of words to express the same idea, and both rest upon the hypothesis that these two companies did not have the right to adjust amicably their patent differences, but were compelled by the Sherman Act to fight out the impending patent litigation to the bitter end. We believe it has never heretofore been held that the Sherman Act was intended to promote freedom of litigation. We had thought that it was intended to promote freedom of commerce. Litigation is not commerce. It is frequently an interference with commerce.

Patents are presumptively valid. The Master has found in this case that the patents are valid. The Court

below has not disturbed that finding, but on the contrary, said (III 2001):

> "Without discussing each patent at length and in detail, we will content ourselves with a statement of our conclusions. For the purposes of this suit, we are not willing to disturb the Master's finding that the patents are valid."

This case has been in the courts since July, 1924. It has taken more than six years to try it. The Government, with all of its vast resources, has been allowed to attack the validity of its own patents. It has failed to sustain this attack. Patent litigation is notoriously slow, difficult, expensive and uncertain. If these two companies, instead of adjusting their differences, had contested the validity of each other's patents, they would have been engaged in litigation for many years; they would have been conducting their cracking operations in fear and trembling; they would have been hampered in their development program; they would have been disabled from using the improvements and inventions of each other; the efficiency of their cracking operations would have been impaired; and at the end of long years of litigation, what would have been the result? Doubtless the result would have been the same as that reached in this case, namely, that their respective patents were valid and that in some particulars, each was infringing the patent rights of the other. Certainly this is a reasonable statement because after all the years of litigation through which this case has passed, that is the result which has been reached. At the end of such a controversy what would these companies have faced? The same situation which they faced in 1921 and the same necessity for a settlement. In the meantime, there would have been chaos in the industry instead of contentment.

(e) *The Effect of this Contract.*

As applied to The Texas Company, the effect was to give it protection for its own large operations under the patent rights of the Standard Oil Company (Indiana) as well as under its own, and also 25% of the royalties then being collected by the Indiana Company from its existing licensees.

Its effect as applied to the Standard Oil Company (Indiana) was to give that company a license to use the Holmes-Manley Process and to protect its past and future operations of the Burton Process.

Its effect on the existing licensees of the Indiana Company was to relieve them from infringement actions by The Texas Company without increasing the royalties they were then paying the Indiana Company.

Its effect on future licensees was to give them protection under the patent rights of both The Texas Company and the Standard Oil Company (Indiana) and to permit them to use either the Holmes-Manley Process or the Burton Process or any combination thereof without paying any higher royalty than the Indiana Company's licensees had been paying for the use of the Burton Process alone.

Its effect on the competitive situation was to enable both parties to the contract and all their licensees to continually increase their output of gasoline, to market it without any additional restrictions, and to place them all in a stronger competitive position with each other and with other competitors in the industry.

Its effect on the public was to insure an increased supply of gasoline in order to meet the growing demands of the consumers.

The only restraint imposed upon either party was a restraint upon litigation.

(f) *The Prayer of the Petition* (I 41).

The prayer was only directed against the so-called restrictive covenants. It did not seek to strike down the agreement as a whole. The only restrictive covenant in this contract attacked by the prayer was the option clause.

(g) *The Decree* (III 2020).

While the opinion of the lower Court held that this agreement was valid as a cross-licensing agreement, the decree struck it down entirely.

FOURTH: CONTRACTS NUMBERS 55 AND 74.*

The Texas Company was negotiating these two agreements during the same time, and from its standpoint, they may be considered together.

Contract Number 55 is an agreement between The Texas Company and Gasoline Products Company, Inc., dated January 26, 1923. Gasoline Products Company was not a refiner, but merely the owner of patents under which it had developed the Cross Process, and its entire business was the development of that process and obtaining revenue by licensing it to the refining industry. By this agreement, The Texas Company, Section 7, permitted Gasoline Products Company to issue licenses under the patent rights of The Texas Company to the present and future licensees of the Gasoline Products Company for the practice of the Cross Process, as defined in Section 5. Gasoline Products Company agreed, Section 6, not to sue The Texas Company or any of its present or future licensees for infringement of patents of the Gasoline Products Company by reason of the practice of the Holmes-Manley Process. By Section 8 The Texas Company agreed to make an effort to secure for

* 55 is dated January 26, 1923 (III 1579) and 74 is dated September 28, 1923 (III 1749).

Gasoline Products Company the right to license the Cross Process under the patents of Standard Oil Company (Indiana) and Standard Oil Company (New Jersey). The Gasoline Products Company agreed to pay The Texas Company for the license under The Texas Company's patents only two cents per barrel of stock charged by its licensees (2.4 cents as to future licensees), or 30% of the royalties collected. In the event The Texas Company secured a license for Gasoline Products Company under the patents of Standard Oil Company (Indiana), Gasoline Products Company agreed to pay The Texas Company out of the royalties collected from its future licensees an additional 1.2 cents per barrel charged, or 10% of the royalties collected, whichever was greater, and in the event The Texas Company secured a similar right for the Gasoline Products Company from Standard Oil Company (New Jersey), Gasoline Products Company agreed to pay The Texas Company an additional .9 of a cent per barrel charged, or 10% of the royalties collected, whichever was greater.

Contract Number 74 is an agreement between The Texas Company, Standard Oil Company (New Jersey) and Standard Oil Company (Indiana) dated September 28, 1923. By this agreement the Tube and Tank Process, the Holmes-Manley Process, and the Burton Process are defined and each of the three parties licenses the others for the practice of their respective processes, without the payment of royalty. The Texas Company also procured for Gasoline Products Company licenses for the Cross Process under the patent rights of Standard Oil Company (New Jersey) and Standard Oil Company (Indiana). By Section 7, the New Jersey company agrees to pay to the Indiana company one-half of the royalties collected by it from licensees of its Tube and Tank Process, or 5¢ per barrel of oil run by such licensees, whichever is greater. Litigation

between The Texas Company and the New Jersey company and litigation between the New Jersey company and Gasoline Products Company was settled. This litigation was very serious, as is shown by the testimony hereinafter quoted at pages 31 to 37.

The Prayer of the Petition.

Neither of these agreements contains any of the so-called restrictive covenants attacked by the Bill and if the decree had been no broader than the Bill, these two contracts would not have been affected.

The Opinion of the Court.

The opinion holds that these agreements are valid insofar as they are cross-licensing agreements, but are invalid to the extent they go beyond cross-licensing (III 2017).

The fact is, however, that these agreements are merely cross-licensing agreements. Nothing else can be read into them. Gasoline Products Company and Standard Oil Company (New Jersey) had the weaker patent positions and on account of this fact agreed to pay The Texas Company or the Indiana company a part of the royalties collected by them from their licensees, but this does not alter the fact that the agreements were purely cross-licensing agreements.

In discussing these two agreements the Court in its opinion makes no reference whatever to the reasons why they were made.

The Decree of the Court.

While the opinion of the Court recognizes these agreements as valid insofar as they are cross-licensing agreements, the decree strikes them down entirely (III 2020).

Reasons for Making These Two Contracts.

In Mr. Holmes' testimony he gives the reasons why The Texas Company made these two contracts as follows (II 913):

"On May 9, 1922, the Carleton Ellis patent issued, owned by the Standard Oil Company of New Jersey. In July, 1922, Standard Oil Company of New Jersey brought an infringement suit against the Pure Oil Company, which was a licensee of the Cross Process owned by Gasoline Products Company. The attorneys of The Texas Company and of Gasoline Products Company had been in conference prior to that time. We had also had some conferences with Dr. Cross and I think some of the others prior to that time. I had my first conference with representatives of Gasoline Products Company in June, 1922. My recollection is that Dr. Cross came to see me. In March of that year I had been advised by Mr. Dearborn that the Cross Process, in his opinion, infringed the patent rights of The Texas Company. As I remember the conversation with Dr. Cross, it was about the fact that they had been threatened with suit under the Ellis patent owned by the Standard Oil of New Jersey. We, in the meantime, had learned in March, through a circular that Gasoline Products issued, that their operation apparently was an infringement of our patent rights. The discussion was largely of the situation caused by those conditions, the apparent conflict between our interests and the threatened suit against them by Standard Oil of New Jersey and the Rogers-Adams litigation.

The general thought expressed by Dr. Cross was that Gasoline Products Company and The Texas Company should assist each other, if we could, in making common defense against the Standard Oil Company of New Jersey. After the decree had been entered in the case of Rogers vs. Adams, Standard Oil Company of New Jersey opened negotiations

with The Texas Company with reference to a settlement of that litigation. In the meantime, we had taken an appeal to the Appellate Division which was then pending and it was while this appeal was pending that the negotiations were opened with us by Standard Oil Company of New Jersey. Under this decree Rogers was adjudged the owner of a 40% interest in the Adams patents and The Texas Company was ordered to account to him for 40% of its profits by reason of the operation of the Holmes-Manley Process, past, present and future.

In our contract with the Standard Oil Company of Indiana, No. 31, we had warranted the title to our Adams patents. We were, therefore, confronted with this situation. We had warranted our title to the Adams patents in Contract No. 31 with the Standard Oil Company of Indiana; the Supreme Court had held that Rogers owned a 40% interest in those patents; Gasoline Products Company was in litigation with Standard Oil Company of New Jersey involving the Ellis and Cross patents; The Texas Company was in litigation with Standard Oil Company of New Jersey through Rogers over the ownership of its Adams patents. We had been advised by our Patent Attorney that the Cross Process was an infringement of The Texas Company's patent rights. Under these circumstances we were negotiating with Gasoline Products Company for settlement and with Standard Oil Company of New Jersey for settlement on account of the Rogers litigation. We then made the Contract No. 55 with the Gasoline Products Company on January 26, 1923. By this contract we licensed the Gasoline Products Company in the use of its Cross process under the patent rights of The Texas Company only, but we agreed to open negotiations with Standard Oil Company of Indiana in order to secure for Gasoline Products Company a like protection under the patent rights of that Company. The matter had been up with the Standard

Oil Company of Indiana because of Contract No. 31 with that company and because of our warranty of title to our patents. The Texas Company could not without the consent of Standard Oil Company of Indiana license Gasoline Products Company under the Indiana Company's patents because Gasoline Products Company was not a refiner.

By this Contract No. 55 (Exhibit 55) with Gasoline Products Company, we also agreed to open negotiations with Standard Oil Company of New Jersey with a view of acquiring for Gasoline Products Company immunity under its patent rights. This was done because at that time we were negotiating with Standard Oil Company of New Jersey for settlement of the Rogers litigation and we hoped to work out our settlement, and settlement of the Gasoline Products situation, if possible.

The result of these negotiations was the three-party contract No. 74 (Exhibit 74) dated September 28, 1923, between Standard Oil Company of New Jersey, The Texas Company, and Standard Oil Company of Indiana. This agreement resulted in a settlement of the case of Rogers vs. Adams and a settlement of the infringement action brought by Standard Oil Company of New Jersey against the Pure Oil Company, a licensee of Gasoline Products Company. The Texas Company's title to its Adams patents was also settled.

The Texas Company never at any time, either before or since the making of Contract No. 31, had any control over the form of the license agreement issued by Standard Oil Company of Indiana and has never at any time had any control over the form of the license agreement issued by the Gasoline Products Company. Our only interest was in collecting royalties on account of licenses issued by either of those companies under our patent rights.

This contract with Gasoline Products Company was also publicly announced in the newspapers.

The other contracts between the primary defendants related to the foreign patent situation, and as litigation existing and threatened in this country had been settled, the foreign contracts were regarded as merely auxiliary to the domestic contracts."

Mr. Osborne, President of Gasoline Products Company, testified as follows relative to his company's situation and its reasons for making these contracts (II 839):

"A great many patents in respect of oil cracking issued during this same period on prior applications which were in the Patent Office, including a patent issued on May 9, 1922, to Carleton Ellis on an application filed October 4, 1913. The Standard of New Jersey as assignee of Carleton Ellis started suit in July, 1922, against the Pure Oil Company, on account of its operation of the Cross process under license from Gasoline Products Company.

* * * * * * *

Gasoline Products Company was obligated to and did undertake the defense of that suit under the license agreement and employed counsel and filed an answer in the name of Pure Oil Company. A copy of this answer was offered and received in evidence without objection as Defendants' Exhibit 549. It was an answer in usual form admitting the issuance of plaintiff's patent and receipt of notice of infringement thereof and setting up the usual patent defenses of anticipation by a large number of patents and publications disclosed in the prior art, also other defenses, including double patenting.

The immediate result of the filing of that suit on the business of Gasoline Products Company when it became known was that we found it very difficult indeed to persuade independent refiners to expend any monies on the installation of the Cross Process. They felt that if they did operate the Cross Process

under licenses from us, they were laying themselves open to heavy damages, in view of this suit by Standard of New Jersey, and while some licenses were closed in the balance of the year 1922 those which were closed did not result in the commencement of construction. Not only did we find it difficult to close new licenses but old licensees who had expected to go ahead with large programs of construction held up those programs. The Pure Oil Company in particular had expected to build twenty-six units of the Cross Process at a very large expenditure of money, but when this suit was brought said it would not care to proceed with the completion of the twenty-six units of the Cross process until the suit was settled. I could not blame them for taking this position. Gasoline Products Company advised its licensees that it would defend the suit to the best of its ability and although we had every confidence in our patent situation, counsel advised that it would be an expensive litigation and would take a very long period of time to get the patents adjudicated. In any event, during this time I saw great difficulty in keeping the company going without calling on our stockholders for very large sums of money, because the Company at that time, 1922 and 1923, had an income of only a few hundred dollars against very heavy expenditures. While some of the licensees by the time this suit had come along were beginning to pay, the sums received from them, or which could be expected from them, would not have been nearly adequate to meet the expenses of the Company and the expenses of this litigation, and the Company had no other resources than these, except to call upon its stockholders who had already advanced very considerable sums.

Also our patent counsel advised us that there was the probability that interferences would be declared in the patent office in connection with some of our patents and in their opinion the patents issued on such of those interferences as were declared would

doubtless overlap our issued patents or patents belonging to other of the primary defendants.

I was familiar with the fact that The Texas Company, Standard of New Jersey, and the Standard of Indiana, were making considerable expenditures on experimental work, and it seemed very evident to me that in the development of cracking there would be many improvements made on each process applicable to the others, and that it would be extremely advantageous to our licensees to have for their process the benefit of improvements which were made by these large companies.

In the latter part of 1923, three interferences were declared affecting the Gasoline Products patents and our counsel advised that they might expect—might hope—to win those interferences; they were on important matters which might seriously affect our operations.

The situation of Gasoline Products Company in the summer of 1922 was a very difficult and embarrassing one for the management. We had a large lawsuit on our hands, no income, no resources, no credit, except such as we would get from our stockholders, and commitments to our licensees. Also in the license contracts there were covenants on the part of the corporation to defend patent litigation, and under the Pure Oil Company license Gasoline Products Company was responsible for any damages which might be recovered.

Faced with this situation, it seemed to me desirable first to settle the pending litigation in order to be able to offer licensees a cracking process which they could safely operate. In addition to settling the pending litigation it seemed advisable as far as possible, to forestall further litigation, and for that reason, instead of considering only the litigation which was then at issue with Standard of New Jersey, I had our attorneys report their opinion of the general state of the cracking art, whether there might be overlapping patents other than those of

Standard of New Jersey, who might own those patents and where there might be most serious danger of litigation against our licensees.

Our counsel advised that a large number of companies in the United States held patents of this kind, but that the greatest amount of commercial cracking development had been made by three companies, namely, The Texas Company, Standard of Indiana, and Standard of New Jersey. Therefore, it seemed reasonable to me that those companies would have the largest number of valid patents and improvements on cracking processes.

During the summer of 1922, having ascertained the general situation in regard to cracking processes and patents, I had many conferences with The Texas Company, as well as with Standard of New Jersey, hoping to reach a settlement of the Company's immediate difficulties with the Standard of New Jersey and of the difficulties which patent counsel told me threatened with The Texas Company on some of these interferences. Following these conferences, Gasoline Products Company entered into the Contract No. 55 (Exhibit 55), dated January 26, 1923, with The Texas Company.

The principal benefits which followed the making of this contract were, it seemed to me, that it would enable the independent refiner to employ a cracking process at a reasonable royalty with a greatly diminished threat of litigation. It would enable us to license any independent refiners to employ improvements on the Cross process which I believed would be available as the result of the work of these companies on their own processes."

From the standpoint of The Texas Company these two contracts were perfectly simple, normal and orderly steps in the prosecution of its business, in the protection of its own operations and in freeing itself from important litigation. It was engaged in serious litigation with the

Standard Oil Company of New Jersey and so was Gasoline Products Company. In addition to this, it regarded the Cross Process of Gasoline Products as an infringement of its patent rights. It also believed that the patent rights of Gasoline Products Company threatened its Holmes-Manley operations (II 923). Pure Oil Company, a licensee of Gasoline Products, had been sued by the Standard Oil Company of New Jersey charged with infringement of its Carleton Ellis patent. Gasoline Products thought its defense would be strengthened if it could procure a license under the patent rights of The Texas Company. The Texas Company was advised by its Patent Attorney that the Cross process of Gasoline Products Company was an infringement of The Texas Company's patents. It was willing to license the Cross Process under its patents and thereby obtain revenue, and at the same time join with Gasoline Products in a common defense against the attack of the New Jersey Company. It had a right to grant a license under its own patents upon any lawful terms which it could agree upon with Gasoline Products, notwithstanding Contract Number 31, and it exercised this freedom by making this contract number 55, charging Gasoline Products an agreed percentage of the royalties to be collected by it from its licensees. In order to further protect Gasoline Products Company, and the licensees of Gasoline Products Company, *which by Contract Number 55 became its licensees*, it agreed to make an effort to procure similar protection under the patent rights of the Indiana Company and the New Jersey Company, and this it succeeded in doing by Contract Number 74.

In respect of these two contracts, however, by far the most important consideration, so far as The Texas Company was concerned, was the decree which had been ren-

dered in favor of Rogers in the case of *Rogers v. Adams and The Texas Company*, Rogers having brought the action for the benefit of the Standard Oil Company of New Jersey. This case was filed in a State Court in New York in 1920, Rogers alleging that under contract between him and Adams made in 1907 he was entitled to a 40% interest in Adams' inventions and patent rights. These Adams patents had been acquired by The Texas Company and covered its Holmes-Manley operations. This case was tried in May, 1922, and at the trial it developed for the first time that the Standard Oil Company of New Jersey was the real plaintiff in the action. A decree was rendered in July, 1922, in favor of Rogers, by which it was adjudged that he was the owner of a 40% interest in the Adams inventions and patents; that The Texas Company, while it had no knowledge of Rogers' claim at the time it acquired Adams' patents, was, under the circumstances, charged with notice and the decree adjudged both Adams and The Texas Company liable to Rogers (Standard Oil Company) for 40% of their revenues and profits from licensing and from operations, both past and future (II 901). This decree put a powerful weapon in the hands of the Standard Oil Company of New Jersey and was very disturbing to The Texas Company. It took an appeal to the Appellate Division and while this appeal was pending the negotiations were conducted which led up to the execution of both these contracts. Before Contract No. 74 was actually signed the decision of the trial court was affirmed by the Appellate Division, but the right of appeal to the highest court of the State still existed.

The important feature of Contract No. 74 was that it disposed of this litigation and the Standard Oil of New Jersey procured an assignment of the Rogers claim to The

Texas Company which thereby became 100% owner of the Adams patents and was freed from the obligation to account for 40% of its profits to the Standard Oil of New Jersey, and it also freed itself from its liability to Standard of Indiana, due to its having, by Contract 31, warranted its own title to the Adams patents, which the decision in the *Rogers* case had upset.

Notwithstanding the decree in the *Rogers* case, The Texas Company was not helpless in dealing with the Standard Oil Company of New Jersey. In addition to the right of appeal, it owned the Hall patent which it had procured in the face of sharp competition with the New Jersey company. Mr. Howard of that company testified that he obtained authority from its Board of Directors to purchase the Hall patent at 2:30 o'clock and then found that The Texas Company had purchased it at 1:00 o'clock. This patent was very important to the New Jersey company because it covered a phase of operation which it had been investigating and in which it was vitally interested. (See Mr. Howard's testimony, II 976.) It was, therefore, in a position in which it was necessary to make a settlement in order to obtain freedom for its own operations and The Texas Company was in position to force the Jersey company into a reasonable settlement which included a license to Gasoline Products.

The Effect of These Contracts.

We now desire to state briefly the effect of these two contracts Numbers 55 and 74

(a) on The Texas Company;
(b) on Gasoline Products Company;
(c) on Standard Oil Company (New Jersey);

(d) on Standard Oil Company (Indiana);
(e) on licensees of all these companies;
(f) on the public.

(a) *The effect on The Texas Company.*

By Number 55 The Texas Company secured protection for its Holmes-Manley Process under the patent rights of Gasoline Products Company. It likewise granted to Gasoline Products Company the right to license the Cross Process under the patent rights of The Texas Company, and for this it received a consideration. By Number 74 it disposed of the case of *Rogers* v. *Adams* and thereby perfected its title to the Adams patents. It likewise procured for Gasoline Products Company, its licensee, authority to license the Cross Process under the patent rights of Standard Oil Company (New Jersey) and Standard Oil Company (Indiana) for which it received a consideration from Gasoline Products Company. By the two contracts, it secured protection for its own operation of the Holmes-Manley Process. It likewise secured protection for its licensees of the Holmes-Manley Process without any additional cost to them.

(b) *The effect on Gasoline Products Company.*

Gasoline Products Company was enabled to license its Cross Process under the patent rights of The Texas Company and the two Standard Oil Companies without any restrictions as to time, place, or royalties charged. For this right, it paid The Texas Company a part of the royalties collected. Being only a licensing company, its business was greatly stimulated by the comprehensive nature of the patent protection it was able to offer the licensees of its Cross Process.

(c) *The effect on Standard Oil Company (New Jersey).*

This Company secured immunity for the practice of its Tube and Tank Process under the patent rights of the other three companies, including the Adams Patents and the Hall Patents of The Texas Company which were very necessary to its operations and all without the payment of royalty. It likewise secured a refund of 25% of the royalties it was paying the Indiana Company for its Burton operations, this being the amount which The Texas Company was receiving under Contract 31. (The New Jersey company was one of the old licensees of the Indiana company when No. 31 was executed.)

(d) *The effect on Standard Oil Company (Indiana).*

After Contract Number 31 was executed Standard Oil Company (Indiana) made very large installations of the Holmes-Manley Process with some modifications. It was, therefore, vitally interested in having The Texas Company acquire 100% title to the Adams patents in order to protect its own operations. By Contract No. 74 it procured this protection through the settlement between The Texas Company and Standard Oil Company (New Jersey) of the *Rogers v. Adams* litigation. It also secured immunity for its Burton operations and also its modified Holmes-Manley operations without cost under the patent rights of the other three companies, and in addition, 50% of the revenues received by Standard Oil Company (New Jersey) from future licensees of its Tube and Tank Process.

(e) *The effect on licensees of all these companies.*

All licensees of either one of the four companies were afforded protection under the patent rights of the other companies without additional cost to them.

(f) *The effect on the public.*

As all patent litigation and conflict between these four companies was disposed of and as each one of the four companies was free to license its process to all other refiners, the effect was to stimulate the cracking industry and produce a great increase in the output of cracked gasoline, thus insuring the public an ample supply under extremely competitive conditions.

It is interesting to note the effect of this group of contracts on the supply of gasoline. Contract No. 31 was made in 1921 and contracts Nos. 55 and 74 in 1923. The tabulation heretofore set out in this brief shows that the output of cracked gasoline during the years 1920 to 1925, both inclusive, was as follows:

Year	Cracked Gasoline Gallons
1920	678,174,000
1921	892,626,000
1922	1,065,876,000
1923	1,190,280,000
1924	1,443,036,000
1925	2,880,486,000

Attention is called to the sharp increase in 1921 over 1920 and to the still sharper increase of 1925 over 1924. Cracking units are very expensive and the construction of them takes much time. The full effect of the settlements of 1923 were, therefore, not obtained until after the lapse of some time, but it will be noted that in 1925 the cracked gasoline increased approximately 100% over 1924.

There were other cracking processes being used and we do not claim credit for all of this increase. Counsel for the Government, however, did contend, and the Court in its opinion found that these primary defendants and their respective licensees produced 93.96% of all cracked gasoline

produced in 1924 (II 2004). The defendants disagreed with this contention, being of the opinion that the output of other cracking processes was approximately 45% of the total (II 868), but whatever the percentage may be (and the record does not disclose it exactly) the fact is that after the settlement of the patent conflicts by these three contracts, the supply of cracked gasoline increased enormously, and that these four primary defendants and their numerous licensees, all in active competition in the market (as found by the Master, I 612, 652, 659, 660, 662, and not denied by the lower Court), contributed a very large part of this increase. We respectfully submit that these figures demonstrate that the contracts promoted commerce and in no wise restrained it, and that, therefore, the public was benefited as well as the various parties.

FIFTH: THE REMAINING PRIMARY AGREEMENTS ARE VALID.

Only a word need be said about the other primary agreements. They are numbers 73, 75, 76, 77, 78 and 79.* No. 73 is similar to No. 74 and relates to patent rights in foreign countries. Patent conflicts having been adjusted in the United States by No. 74, it was obvious that the adjustment should extend to other countries as well, as it would have been sheer folly to conduct foreign operations under the threat of patent infringement after adjustments had been made in the United States. No. 75 is the license granted by Standard Oil Company (New Jersey) to Gasoline Products Company and No. 76 is the license granted by Gasoline Products Company to Standard Oil Company (New Jersey), both being granted in accordance with the provisions of Contract No. 74, and therefore being merely steps in performing Contract No. 74. It will be remem-

* These are all in Vol. III, 72 at page 1737; 75, page 1772; 76, page 1774; 77, page 1777; 78, page 1792 and 79, page 1794.

bered that by Contract No. 55 Gasoline Products Company became the licensee of The Texas Company and was authorized to grant licenses for the Cross Process to other refiners under the patent rights of The Texas Company. Being its licensee, The Texas Company naturally was under some moral obligation to protect Gasoline Products Company and this it did pursuant to Contract No. 74. No. 77 is the license granted by The Texas Company to Gasoline Products Company covering patent rights in foreign countries. No. 78 is the foreign license by Standard Oil Company (Indiana) to Gasoline Products Company, and No. 79 is the foreign license by Gasoline Products Company to Standard Oil Company (Indiana), these two cross-licenses being executed pursuant to Contract No. 74. These agreements are all mere licensing or cross-licensing agreements. They contain none of the covenants which the bill characterized as "restrictive" and all are without royalty except 77, in which Gasoline Products Co. agrees to pay The Texas Co. 20% of its net *foreign* royalties. They are, therefore, valid within the opinion of the lower Court, and yet the decree strikes them down entirely.

We conclude the discussion of these primary agreements, therefore, with a repetition of what we said at the outset, namely, that the only contracts which need be considered by the Court are those numbered 31, 55 and 74, and that thus understood this case, notwithstanding the length of the record, is a very simple one.

SIXTH: THE PRIMARY AGREEMENTS AS A WHOLE HAVE PROMOTED AND NOT RESTRAINED COMMERCE.

We have studied these contracts individually, and, as we think, have demonstrated that they are not subject to criticism. If we view the situation in a larger aspect it becomes even clearer that there has been no restraint of trade. Mr. Holmes' testimony (II 866) gives a history

of The Texas Company from the time of its incorporation in 1902 to date. It shows a continually expanding field of business by an independent company, which in 1926 had 33,680 stockholders, which owned no stock in any of the defendants and which included none of the other defendants in its list of stockholders. It is engaged in business throughout the United States and in many foreign countries. In the United States it is engaged in the business of producing, transporting, refining, and marketing petroleum and its products, and carries on extensive marketing operations in foreign countries. Since Contract No. 31 was made with the Standard Oil Company of Indiana, The Texas Company has freely extended its producing, refining, and marketing operations in the so-called Indiana territory, as well as throughout the rest of the country. The maps showing its marketing operations (Exhibits 507 to 510, II facing 896) plainly show the steady advance into the so-called Indiana territory. Its producing, transporting, refining and marketing operations are all carried on in direct and active competition with the other defendants in this case. Mr. Holmes testified that The Texas Company has no contract, agreement or understanding, express or implied, explicit or implicit, with any other company restricting the full and perfect freedom of its operations, and there is no testimony in the case tending to show the contrary.

We invite the Court's attention to Mr. Holmes' testimony as a whole, and call particular attention to Exhibits 507 to 510, both inclusive, which show in a pictorial way the extent of The Texas Company's marketing operations as of January 1, 1911, January 1, 1916, January 1, 1921, and September 1, 1925. The Exhibit No. 509 showing the marketing situation as of January 1, 1921, is shortly before Contract No. 31 was executed, while the Exhibit No. 510

showing the situation as of September 1, 1925, is some four years thereafter, A comparison of those two exhibits will show that The Texas Company has practically covered the so-called Indiana territory since Contract No. 31 was executed. In addition to extending its marketing operations throughout that territory, it has also built a refinery at Casper, Wyoming, and a small one at Craig, Colorado, both in the so-called Indiana territory. Here is demonstration that there has been no agreement between The Texas Company and the Indiana Company to restrict marketing operations, and that the primary agreements neither explicitly nor implicitly have in any way affected the normal expansion of The Texas Company's business.

The exhibits offered by Mr. Holmes, Nos. 491 to 497 (II 871/881) both inclusive, demonstrate that there has been no restraint of trade or of progress in the petroleum industry. These are the graphs showing the crude oil production in the United States and in the world, the comparison of the production in the United States with the crude run to stills, the comparison of the crude run to stills with the refinery output, the comparison of the crude run to stills with the kerosene output, the comparison of the crude run to stills with the lubricating oil output and the total gasoline production, including straight run, cracked and all other. The last mentioned graph is of particular interest. It shows that up to 1912 there was no cracked gasoline; that in 1914 the output of cracked gasoline was 2,028,000 barrels, which was equal to 5.67 per cent. of the total gasoline output, while in 1925 the total yield of cracked gasoline was 68,583,000 barrels or 25.78 per cent. of the total output of gasoline in the United States. In other words, but for the development of the cracking art the automobiles of the world could not move today. If the supply of gasoline were reduced 25.78 per cent., there would not be enough

gasoline to supply the demand. It would mean that the supply of automobiles would have to be reduced 25.78 per cent., or that the automobile mileage would have to be reduced 25.78 per cent., and that the price of gasoline might reach the figure predicted by the LaFollette committee of one dollar per gallon.

The importance of cracking is well stated in a pamphlet issued by the Bureau of Mines from which we quote the following (II 1009):

> "According to the best information available, about 26% of the gasoline output of the refineries for 1925 was produced from heavier oils by cracking. This represents a production of approximately 2,824,000,000 gallons of gasoline by the use of cracking processes as compared to 400,000,000 gallons in 1918 and 1,000,000,000 gallons for the 5-year period preceding 1918. In other words, almost 7 times as much gasoline was made by cracking in 1925 as in 1918, and almost 3 times as much as for the 5-year period preceding 1918.
>
> This large production of cracked gasoline has been an extremely important factor in the providing of an adequate supply of motor fuel, as it has greatly increased the amount of gasoline available, without a corresponding increase in the production of crude oil. On the basis of the estimated yield of gasoline by straight distillation (23.4%) in 1925, it would have required approximately 287,000,000 barrels additional of crude oil to furnish the gasoline made by cracking processes."

In this connection we call attention to the figures for The Texas Company alone for the years 1920 to 1924, both inclusive. The first column shows the year, the next column shows the total production of gasoline by The Texas Company for that year, and the third column shows the quan-

tity of cracked gasoline constituting a part of the total shown in the second column (II 868).

Year	Total Production	Cracked Gas
1920	6,595,398 bbls.	501,971 bbls.
1921	6,651,326 "	1,184,352 "
1922	7,351,917 "	1,783,643 "
1923	10,012,621 "	3,755,530 "
1924	14,355,194 "	7,536,955 "

It is to be noted that in 1920 cracked gasoline constituted less than eight per cent. of The Texas Company's total output, while in 1924 the cracked gasoline output had increased to more than fifty per cent. of the total.

We also call attention to Exhibits Nos. 500 to 505, both inclusive (II 885/895), being graphs secured from the Bureau of Standards of the Department of Commerce, and showing a comparison of gasoline prices with other necessary commodities, such as fuel and lighting, building materials, the price of foods, price of cloth and clothing, price of house furnishing goods, and a comparison of gasoline prices with all commodities. These graphs show that gasoline is the cheapest commodity and comes nearer being on a prewar basis than any of the others or than the whole. This has been made possible by the progress of the cracking art, and the progress of the cracking art has been due in the main to the research work, experiments and developments of the four primary defendants in this case, and to these agreements which they have made by which all of their improvements and patents have been made available to the refining industry.

Instead of making these so-called primary agreements these four defendants might have kept up the litigation amongst themselves; might have spent their money on law suits instead of on development; might have lived in fear

and trembling of having to account to one or the other litigant for all their profits, and might have let the American public pay fifty cents a gallon for gasoline. Perhaps the Department of Justice would have applauded this course, but the twenty million automobile owners of the United States would have felt the burden.

Conclusion.

We believe that this record discloses that the agreements involved in this case (a) were beneficial to the primary defendants; (b) were beneficial to their licensees; (c) were beneficial to the refining industry generally; (d) were beneficial to the public; (e) resulted in greatly increasing the supply of gasoline; and (f) promoted, instead of restraining, commerce.

We, therefore, respectfully submit that the judgment of the District Court should be reversed.

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